

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:PEN:PHI:TL-N-5442-99

JCFee

date:

to: Chief, Quality Measurement Staff, Pennsylvania District
Attn: Marshall Lyons

from: Assistant District Counsel, Pennsylvania District, Philadelphia

subject:

EIN: [REDACTED]; Tax Years: [REDACTED], [REDACTED], [REDACTED], and [REDACTED]
Computation Date for Accrual of Deficiency Interest

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

You have informally requested our legal advice on the proper date for computing deficiency interest where the taxpayer has elected to apply it overpayments of tax per return to the following year's estimated tax deposits.

ISSUE:

At what date does interest begin to run on a deficiency in tax for a particular year, where the taxpayer had previously reported an overpayment of tax on its return and elected to have the overpayment credited against its estimated tax liability for the succeeding year.

CONCLUSION

To the extent the taxpayer's deficiency results from an overpayment credit used to satisfy a subsequent year's estimated tax liabilities, deficiency interest will be assessed as of the dates the excessive overpayment credit is applied to the succeeding year's estimated taxes. Interest will be computed as of the original due date of the succeeding year's income tax return, if the excessive overpayment credit was not needed to satisfy specific installments of estimated tax.

FACTSTAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the corresponding subsequent tax year's estimated taxes. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter of the [REDACTED] tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254. Accordingly, the Service applied the entire overpayment to the first [REDACTED] estimated payment as of [REDACTED].

On audit, the Service determined a deficiency of \$ [REDACTED] for [REDACTED] (less than the amount of \$ [REDACTED] reported return overpayment). The \$ [REDACTED] deficiency was paid by the application of credits as of [REDACTED] from prior tax years. The [REDACTED] date of application was the due date of the [REDACTED] tax return. The Service determined that deficiency interest was not due since the assessed deficiency of \$ [REDACTED] was considered paid as of the due date of the [REDACTED] return. The Service also determined that overpayment interest was not due on the \$ [REDACTED] of credits applied to the [REDACTED] year on [REDACTED] and used to pay the deficiency.

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the subsequent tax year's ([REDACTED]) estimated tax liability. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the

reported overpayments to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount of \$[REDACTED] (more than the reported return overpayments of \$[REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s [REDACTED] deficiency, the Service concluded that interest should run on \$[REDACTED] (equalling the [REDACTED] credit elect to [REDACTED]) of the deficiency from August 15, [REDACTED], the due date of the first installment of [REDACTED] estimated payments. The interest on the balance of the deficiency was computed from the due date of the [REDACTED] return, of course.

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$[REDACTED] which [REDACTED] elected to apply to the corresponding subsequent tax year's ([REDACTED]) estimated taxes. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount \$[REDACTED] (less than the reported return overpayments of \$[REDACTED] for [REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s [REDACTED] deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$[REDACTED], which [REDACTED] elected to apply to the corresponding subsequent tax year's ([REDACTED]) estimated taxes. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On Audit, the Service determined a deficiency for [REDACTED] in the amount \$[REDACTED], which includes an advance payment of a proposed deficiency of \$[REDACTED]. (The total of \$[REDACTED] is less than the reported return overpayments of \$[REDACTED] for [REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s [REDACTED] deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

Claims For Refund

[REDACTED] has now filed claims for refund for each of the tax years discussed herein. As to the year [REDACTED], based on the use of money principles with respect to payments received for payment of taxes not due and payable until application of the reported overpayments for the year [REDACTED]. We are not rendering an opinion as to the [REDACTED] claim since the facts for this year do not fit into the normal "Sequa" type claim pattern. The [REDACTED] year will be submitted for Field Service Advice and accordingly will be the subject of separate advice from our Office.

As to the years [REDACTED], [REDACTED] and [REDACTED], with respect to the deficiency interest assessed and paid based on use of money principles, [REDACTED]'s takes the position, that since it did not need the entire overpayment to avoid the estimated tax penalty, interest should not begin to accrue until the overpayment is needed or used to pay the installment due. Based on the analysis submitted by [REDACTED] with its claim, the overpayment is applied as follows:

OVERPAYMENT CREDIT APPLIED TO

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
	\$	\$	
	\$	\$	
	\$	\$	
	\$		

OVERPAYMENT CREDIT APPLIED TO

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
	\$	\$	\$
	\$	\$	
	\$	\$	
	\$	\$	\$

OVERPAYMENT CREDIT APPLIED TO

<u>Installment Period</u>	<u>Installment Due¹</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
	\$	\$	
	\$	\$	\$
	\$	\$	
	\$	\$	\$

¹ We are constrained to note that in performing an analysis of what portion of an overpayment is applied to a quarterly estimated payment to avoid the penalty, there is has been no effort by the Internal Revenue Service to verify the taxpayer's computations of required installments. In other words, the amount due is based entirely on the Forms 2220 as filed.

LAW AND ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer elects to credit an overpayment from a return (i.e. the taxpayer makes a "credit elect") and the credit is applied in full against a particular installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency equal to or less than the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run. Prior to that date the government has had the use of the funds with respect to the prior year's tax.

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should apply the credit. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984 for the first and second installments. The court concluded the Service's application of taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, 1999-40 IRB 1, the Service reconsidered the manner in which deficiency interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure

to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency from the date the credit is applied to the succeeding year's estimated taxes. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

For [REDACTED]'s [REDACTED] tax year, the deficiency amount exceeded the overpayment claimed on the return and credited to the [REDACTED] tax year. Therefore as a result of the deficiency, it was subsequently determined that the taxpayer had not actually been entitled to any part of the overpayment credit (i.e., the credit elect). Nevertheless, under May Department Stores and Rev. Rul. 99-40, the government is deemed to have had the use of the taxpayer's money (i.e., the credit elect amount) until the credit elect is applied to the subsequent year's estimated tax liability or the subsequent year's income tax liability.

To avoid the [REDACTED] estimated tax penalty, [REDACTED] did not need any of the \$[REDACTED] credit elect from the [REDACTED] tax year. The \$[REDACTED] credit elect is deemed to apply to the [REDACTED] income tax liability on [REDACTED], the due date of the [REDACTED] tax return. Accordingly, interest on \$[REDACTED] should begin to run on [REDACTED], the due date of the [REDACTED] return. Deficiency interest on the balance of the deficiency (\$[REDACTED]) should run from the due date of the [REDACTED] return, of course.

For tax years [REDACTED] and [REDACTED], the credit elect amount was well in excess of the subsequently determined deficiencies. [REDACTED] was ENTITLED to an overpayment of \$[REDACTED] in [REDACTED] and \$[REDACTED] as shown below:

Credit Elect	\$ [REDACTED]	\$ [REDACTED]
Less: Deficiency	[REDACTED]	[REDACTED]
Credit Elect to which		
[REDACTED] was ENTITLED	\$ [REDACTED]	\$ [REDACTED]

The taxpayer also made estimated tax payments of \$ [REDACTED] for [REDACTED] and \$ [REDACTED] for [REDACTED].

Since the [REDACTED] total estimated tax liability of \$ [REDACTED] was fully satisfied by (1) the [REDACTED] credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made, none of the "excessive" credit elect that created its [REDACTED] deficiency was used to satisfy the [REDACTED] estimated tax liability. Accordingly, interest on the [REDACTED] deficiency should begin to run on [REDACTED], the due date of the [REDACTED] return.

The [REDACTED] estimated tax liability was satisfied as follows in accordance with Situation 2 of Rev. Rul. 99-40:

<u>Installment Period</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Application of Credit Elect to which TP is ENTITLED</u>	<u>Application of Excessive Credit Elect</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (a)	[REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (a)	\$ [REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (b)	[REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED] (b)	\$ [REDACTED] (c)	\$ [REDACTED]
Totals	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

(a) The taxpayer paid \$ [REDACTED] for the first quarter, of which only \$ [REDACTED] was required to satisfy the estimated tax liability; the balance of \$ [REDACTED] was carried to the second quarter. The \$ [REDACTED] when added to the second quarter estimated payment of \$ [REDACTED] equals the \$ [REDACTED] second quarter amount above.

(b) The taxpayer paid \$ [REDACTED] for the third quarter, of which only \$ [REDACTED] was required to satisfy the estimated tax liability; the balance of \$ [REDACTED] was carried to the fourth quarter. The \$ [REDACTED] when added to the fourth quarter estimated payment of \$ [REDACTED] equals the \$ [REDACTED] fourth quarter amount above.

(c) This amount represents the balance of the \$ [REDACTED] credit elect from 9 of the fourth installment was satisfied by the "excessive" credit elect that created its [REDACTED] deficiency.

Except for \$ [REDACTED], the entire [REDACTED] estimated tax liability was satisfied by (1) the [REDACTED] credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made. Accordingly, interest on \$ [REDACTED] of the [REDACTED] deficiency should begin to run on [REDACTED], the due date of the fourth estimated tax installment. Interest on the balance of the [REDACTED] deficiency (\$ [REDACTED]) should begin to run on [REDACTED], the due date of the [REDACTED] return.

To summarize, deficiency interest shall be computed with reference to the following:

[REDACTED]		[REDACTED]
<u>DEFICIENCY INTEREST REBATE - FISCAL</u>		
<u>YEAR</u> [REDACTED]		
[REDACTED]	FYE OP Credit Elect to FYE [REDACTED]	[REDACTED]
Deficiency Assessed Per Transcript:		
[REDACTED]	Assessment	[REDACTED]
[REDACTED]	Advance Pmt. Proposed Def.	[REDACTED]
Total Deficiency [REDACTED]		
Interest Start date:		On:
[REDACTED]	Due date of [REDACTED] Return	[REDACTED]
[REDACTED]	Due date of [REDACTED] Return	[REDACTED]
Total Deficiency [REDACTED]		

[REDACTED]		[REDACTED]
<u>DEFICIENCY INTEREST REBATE - FISCAL</u>		
<u>YEAR</u> [REDACTED]		
[REDACTED]	FYE OP Credit Elect to FYE [REDACTED]	[REDACTED]
Deficiency Assessed Per Transcript:		
[REDACTED]	Assessment	[REDACTED]
[REDACTED]	Assessment	[REDACTED]
[REDACTED]	Advance Pmt. Proposed Def.	[REDACTED]
Total Deficiency FYE [REDACTED]		
Interest Start Date :		On:
[REDACTED]	Due Date [REDACTED] Return	[REDACTED]

DEFICIENCY INTEREST REBATE - FISCAL
YEAR

FYE OP Credit Elect to FYE

Deficiency Assessed Per Transcript:

Assessment

Advance Pmt. Proposed Def.

Total Deficiency FYE

Interest Start Date:

Form 2220

Due Date of Return

Total OP Applied to Deficiency

This concludes our advice and recommendation. Please feel free to call Attorney James C. Fee, Jr. at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory 10 day post review. To assure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayer's claim prior to .

JOSEPH M. ABELE

Assistant District Counsel

cc: Assistant Regional Counsel (Tax Litigation) (CC:NER)
Office of Assistant Chief Counsel (Field
Service) (CC:DOM:FS)